



Special Committee on Organised Crime, Corruption and Money Laundering (CRIM) 2012-2013

Thematic Paper on Money Laundering

**Relationship between Money Laundering,
Tax Evasion and Tax Havens.**

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The extent and context of the issue

Money laundering is a very vast and complex topic, which requires a flexible and thoroughgoing political response to it. The present paper will only deal with the relationship between money laundering tax evasion and tax havens, for practical reasons and to remain in line with the decisions of the European Parliament's CRIM Special Committee. However this is done with the tacit understanding that a narrow approach to anti-money laundering can only result in a concentration of criminal activities to those means that remain inadequately regulated. In other words the channels for money laundering function as communicating vessels where money can flow from one area to all the rest and as such only a holistic approach to anti-money laundering can be effective.

Money laundering is a criminal offence aimed at presenting wealth of illicit origin or the portion of wealth that has been illegally acquired or concealed from the purview of tax and other authorities, as legitimate, through the use of methods that obscure the identity of the ultimate beneficiary and the source of the ill-gotten profits¹. It is a criminal offence whose effects usually are deleterious for the functioning of a polity and pernicious for the socioeconomic fabric, both domestically and globally. The process of laundering money may occur in a variety of ways, such as with the shrewd exploitation of a complex, interweaving web of secrecy jurisdictions and/or tax havens, the manipulation of the concept of legal persons and legal arrangements to concoct 'shell companies' that can operate as covers for corrupt individuals, the abuse of loopholes in existing anti-money laundering legislation, the weak implementation of these rules, the corruption of authorities; all combined with the profiteer culture of numerous established financial institutions and market insiders in developed economies as in the European Union. Regardless of the origin of the money, whether it has been acquired by means of a criminal activity or a punishable offence, the conduits for money laundering effectively are the same.

Because of inadequate disclosure rules, it is far too easy to make use of a company or legal arrangements such as trusts in the EU, to conceal one's identity for the purposes of money laundering. To create extra complexity a web of such legal structures can be bound together, often taking advantage of the lax regulation or opacity in a secrecy jurisdiction, which might as well result in the formation of a shell company with no staff or effective operations. In this respect trusts, foundations and various other types of legal arrangement or entities are also very important for money laundering and tax evasion. The assiduous criminals will opt for the safety of a complex network of facades, even though it might be the case that one may escape the purview of the law with a rather simple legal edifice.

According to estimates by the United Nations Office on Drugs and Crime (UNODC), based on a meta-analysis, US\$2.1 trillion was laundered in 2009, equal to 3.6% of global GDP.² According to the European Commission, Member States lose between 2% and 2.5% of their combined GDP annually to tax crimes.³ Additionally Tax Justice Network estimated that at a global level wealthy individuals hold US\$21-32 trillion of accumulated untaxed wealth offshore⁴.

Seen within the existing political and economic context of the eurocrisis, where several countries have already been submitted to international bailout programmes; where credit channels have been

¹ The Puppet Masters, The World Bank and UNODC, 2011 <http://star.worldbank.org/star/publication/puppet-masters>

² United Nations Office on Drugs and Crime (October 2011) Estimating Illicit Financial Flows Resulting From Drug Trafficking and Other Transnational Organized Crimes Research Report, October 2011, p.5
http://www.unodc.org/documents/data-and-analysis/Studies/Illicit_financial_flows_2011_web.pdf

³ Commission Communication COM(2006) 254, "concerning the need to develop a coordinated strategy to improve the fight against fiscal fraud" 31 May 2006.

⁴ James Henry, Tax Justice Network (2012) The Price of Offshore Revisited New Estimates for Missing Global Private Wealth, Income, Inequality, and Lost Taxes p. 9
http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf

disrupted; where capital flows have been distorted; where the imbalances through the Euro area in general and the Eurosystem in particular continue to grow; where the European Central Bank has taken extraordinary measures to prevent the single currency from disintegrating; where the debt crisis continues to deepen and economic activity to be either stagnant or in decline; where austerity policies accelerate economic contraction and continue to undermine social welfare; it becomes ever more pressing to guarantee that criminal activity does not exacerbate the existing problems nor pose an additional threat to genuine European solidarity and to the efforts for just recovery.

Tax evasion as a multi-faceted challenge

Tax evasion must be addressed effectively for a number of reasons. At first it deprives states from raising sufficient revenues therefore preventing them from implementing social, economic, environmental, cultural and other policies. Tax evasion undermines the efforts of the government to promote welfare and social cohesion; it prevents it from performing its social function. Moreover, it erodes the credibility of democratic institutions, while injuring the trust of citizens in the means and ends of a legitimate, democratic government. In a nutshell it can brew feelings that might evolve into anti-social, anti-democratic and/or europhobic mentalities.

Secondly, those who are in a better position to avoid taxation are the people who can siphon their income into foreign banks or jurisdictions, which usually means that they are better-off. In avoiding their duties and responsibility *vis-à-vis* society and the state, the tax evaders are in effect placing a greater burden on those who eventually pay off the effective costs of taxation, who are in their majority, members of the lower and middle parts of the income distribution. As such tax evasion fosters or widens social inequality while it produces a *de facto* division of citizens between privileged and non-privileged.

Thirdly, tax evasion provides incentives to established financial institutions as well as authorities or politicians to engage in corrupt activities, in quest of their own enrichment or other benefit. Financial institutions/banks are interested in increasing their profits by making use of this stream of funds, even if that implies circumventing the existing rules⁵. Authorities may be enticed to turn a blind eye in this process, so that their own position in power may be consolidated. An example of such a case of outright corruption by authorities pertains to the latest scandal in Greece concerning the so-called 'Lagarde list'⁶.

Fourthly, tax evasion is facilitated by the asymmetries and heterogeneity of the tax and supervision regimes across EU Member States. Low corporate tax rates, a rather minimal corporate tax base and lax supervision in relation to establishing holding companies, are strong incentives for corporations willing to avoid taxation. As such unfair fiscal competition between EU Member States becomes an underlying reality, which is particularly harmful during the ongoing economic crisis in the Euro Area, as it deprives states in need of funds from a substantial amount of revenue. The case of publicly listed Portuguese companies shifting their holding company to the Netherlands, making it in effect a faceless "letterbox company" is a point in notice⁷.

Therefore a more effective tax administration within Member States is needed, combined with a strengthened cooperation and coordination of EU tax policy, without however placing additional burdens on society. A first step towards that laudable end would be the introduction of a Common Consolidated Corporate Tax Base.

⁵ Undue Diligence: How banks do business with corrupt regimes, Global Witness, March 2009

⁶ <http://www.nytimes.com/2012/10/28/world/europe/list-of-swiss-accounts-turns-up-the-heat-in-greece.html>

⁷ Rui Tavares, Bas Eickhout, Question for written answer to the Commission (E-000499/2012)

<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2012-000499+0+DOC+XML+V0//EN>

Pre-emptive measures to identify beneficial ownership and combat tax evasion

Tax evasion is facilitated by onshore and offshore tax havens and by secrecy jurisdictions in non EU countries, while obfuscation of activities of this sort also occurs in EU Member States. To address this aspect of the problem, EU authorities, at a European level and Member State level, must demand full compliance with all international principles, guidelines and best practices and must in addition ask for an equal level of transparency regarding the exchange of information. In addition, the EU and other jurisdictions, in particular the USA, should cooperate in the collection of all related data and information, on a pre-emptive basis; as it already does with other areas of policy such as security issues, exemplified in the PNR and TFTP programmes; without prejudice to the fact that such agreements, envisaging cooperation in serious transnational crime and the proceeds thereof, are in need of thoroughgoing reconsideration, insofar as they challenge fundamental rights and democratic standards.

As regards information exchange there are currently areas where data is hard to access or where complete opacity and unaccountability are the prevailing features. Furthermore variances in banking cultures, as well as the overall heterogeneity in regulations often allow loopholes for cross-regional abuses, where for instance the perfectly legal and respectable banking system of one region also functions as the shadow banking system of another and vice versa. Towards this end the EU should make it a binding requirement for information concerning the beneficial owner of a legal person or of an investment to always be available, so that no one can hide under the complexity, opacity or asymmetries of cross-regional legal relations or the global legal order.

To be effective in meeting the need to combat tax evasion and to identify beneficial ownership, on the basis of the new 2012 Financial Action Task Force (FATF) recommendations and its preceding works from the past decade the EU must proceed with further legislation and regulation that will:

- Demand **full transparency from financial institutions** to provide all information concerning their activities in offshore supervisory authorities. In this respect financial institutions should be discouraged or, if necessary, prohibited from operating in territories that feature on the black lists of the FATF, OECD⁸ and the World Bank's StAR⁹. European banks should ensure all their global subsidiaries are compliant with the EU's Anti-Money Laundering Directive.
- Establish an interconnected and well integrated system of **legal shareholder registries** encompassing the European Union and its Member States, which will feature all necessary information concerning the shareholders of corporations operating within the EU. This registry may be complemented with a risk-based index that will factor in some of the most suspicious aspects of a corporation's operations. The information on this registry should be available to authorities on demand and all corporations should be expected to provide information concerning their beneficial owner, at the moment they are asked to or within 48 hours.
- Create at the level of the EU a **regularly-updated beneficial owner registry**. Information of this kind should be either exchanged or coordinated across the EU without any obstacle, so that instances of fiscal dumping would be avoided and variances in national legislation would not offer a window of opportunity to criminals and to those who make use of legal loopholes in a manner that is sophisticated, structured and systematic, suggesting that their intention is clearly malevolent, to abuse the system rather than conduct normal operations. Information concerning the beneficial owner of an investment or bank account should be recorded in a government registry and made available to tax and law enforcement, while it should as well comply with all principles of just governance, concerning transparency and accessibility. The identity of the

⁸ Organisation for Economic Co-operation and Development

⁹ Stolen Asset Recovery Initiative

owners and controllers of a legal person, legal arrangement or similar structure should always be provided to government registries in order for these entities or arrangements to have legal weight¹⁰.

- Strengthen the **requirements on the function of corporate directors**. Directors should be held accountable for failing to take reasonable steps to prevent money laundering, this should apply regardless of whether they are nominees or not. Information of this sort should, for issues of transparency and democratic legitimacy be made publicly available to citizens, journalists and NGO's among all others, so that an additional layer of social scrutiny may be placed over corporations. In addition only natural persons should be allowed to act as corporate directors; legal persons should not be permitted to fulfil this role as is the case in many Member States.
- Reconsider and reinforce the **rules regarding the due diligence** that corporate registries and financial institutions should perform, always on an accurate risk-based approach, in an attempt to verify that all information pertaining to the beneficial ownership is correct and that no margin for fraudulent or corrupt activity is allowed.
- Introduce requirements for **enhanced due diligence** in cases where politically exposed people are identified, with the option of rendering void or otherwise limiting the transaction in question.
- Formation of a **European Financial Intelligence Unit (EFIU)** whose role shall be to monitor, assess and analyze EU-wide suspicious transaction reports and contracts. This entity could operate within the context of the Single Supervisory Mechanism that will soon be incorporated within the range of responsibilities of the European Central Bank. The EFIU shall exchange information with all authorities dealing with the issues herein and should be legitimate and accountable so that citizens or their elected representatives can at all times scrutinise its operations and guarantee its compliance with all legal and political standards.

The above are some general guidelines and certainly do not exhaust the possible measures the EU may consider in its efforts to extinguish whatever flaws exist in present legislation that currently allow for the creation of shell companies, as well as in its quest to unmask the beneficial owners of corporations operating within the single market. Eventually this will also give rise to the need for a better risk-based assessment¹¹ of clients from the side of private actors. Private entities such as banks must be expected to comply with comprehensive rules on this issue, so that they are fully convinced that they know whom they are dealing with and whether their wealth is of a licit or illicit origin.

The EU should also take effective measures against tax offences. This should include all deliberate illegal attempts and should also be interpreted in a broad light to encompass those sophisticated, structured and/or systematic uses of legal means for tax avoidance, those methods of fiscal engineering that foster aggressive tax planning. In addition it should be made a practice that a corporation originating in one EU Member State should comply with the rules and regulations that apply in its country of origin even when it holds operations at other EU Member States, even though the ideal would be to introduce harmonised or common rules across the EU. The rationale is to discourage the malevolent use of existing asymmetries in tax regimes and supervisory practices, which distorts competition among private entities within the single market and which engenders unfair fiscal competition between Member States. Some corporations are capable of enjoying lesser

¹⁰ Some countries already operate bank account registries: Markus Meinzer, "Bank account registries in selected countries Lessons for registries of trusts and foundations and for improving automatic tax information exchange" Tax Justice Network and CCFD 21 August 2012 <http://www.taxjustice.net/cms/upload/pdf/BAR2012-TJN-Report.pdf>

¹¹ Transparency International, Review of the Third Anti- Money Laundering Directive http://ec.europa.eu/internal_market/company/financial-crime/received_responses/responses-to-the-consultation/transparency-international_en.pdf

burdens than others by means of their economic clout and their panoply of legal advisors who detect and effectively abuse with impunity whatever gaps exist in the legal framework. It must be stated that such measures are in line with the letter and the spirit of Articles 151-153 TFEU, concerning social issues; and since society, especially certain vulnerable groups, are the ones who suffer the most from such an uneven distribution of responsibilities, these issues must not be dismissed or taken lightly.

Societal aspects of the fight against money laundering and tax evasion

An additional line of defence or of scrutiny must be civil society in general and in particular those groups or sectors, such as journalists, NGOs and the academia, which all perform the benign role of balancing, assessing and checking power.

Social partners should be incentivised to monitor the implementation of all rules and to detect any malpractices, and should furthermore be guaranteed full protection from any kind of censorship and politically motivated prosecution. Investigative journalism is of paramount importance in this regard, as it performs the function of not only revealing existing crime or mischief, but also of deterring possible future crime. The sources of investigative journalists should at all times be kept secret in order not to jeopardise ongoing investigations and not to discourage future ones.

Proactive support of investigative journalism in these times of technological and economic transition should be considered as an amiable end, especially in respect to its crime- and corruption-containing impact. In addition, whistleblowers or NGOs involved in the efforts to unearth graft and corruption, incompetence of authorities and/or malpractices of private entities, should at all times enjoy all necessary protection and support.

Anti-money laundering and tax havens

As there are substantial similarities between the techniques used to launder the proceeds of crime and to commit tax crimes, in May 1998 the G7 Finance Ministers encouraged international action to enhance the capacity of anti-money laundering systems to deal effectively with tax-related crimes.

The G7 correctly considered that coordinated international action in this area would strengthen existing anti-money laundering mechanisms and would increase the effectiveness of information exchange arrangements in tax issues. In this respect the OECD's Committee on Fiscal Affairs has established a dialogue with the Financial Action Task Force and continues to examine ways of improving co-operation between tax and anti-money laundering authorities.

Joint workshops with tax and anti-money laundering officials have been held allowing experts to share experiences on some of the practices that are common to both tax evasion and money laundering. OECD work on tax crime and money laundering is designed to complement what has already been carried out by FATF.

Control of the transfer of assets to tax havens

The use of tax havens by individuals can be limited with the instruments from the anti-money laundering policy in view of controlling the transfer of assets to tax havens. As regards the application of the FATF recommendations as enshrined in the 3rd AML Directive, the use of tax havens currently can only be controlled indirectly or in case of an underlying precursor offence to which simple tax evasion does not belong yet and of which it is not sure whether the European legislator will succeed in introducing this on the basis of the new 2012 FATF Recommendations. There are however initiatives at FATF level to classify tax evasion as a precursor offence for money laundering which aim at improved transparency to make it harder for criminals and terrorists to conceal their identities or hide their assets behind legal persons and arrangements.

The revised FATF Recommendations also refer to tax crimes, which have been included in the list of crimes which countries must treat as predicate offences for money laundering. This will bring the proceeds of tax crimes within the scope of the powers and authorities used to combat money laundering. The smuggling offence has also been clarified to include offences relating to customs and excise duties and taxes. This will contribute to better coordination between law enforcement, border and tax authorities and remove potential obstacles to international co-operation regarding tax crimes.

Possible ways forward: Interlinking policy fields in relation to tax havens

Tax havens appear to be relevant to a number of policies beyond tax policy narrowly understood. They are overlapping with other issues such as the fields of trade or development policy which can be reconsidered in light of achieving specific goals in tax policy. The objectives of policy areas such as anti-fraud, financial and corporate law, crime prevention and anti-money laundering, can be achieved by incorporating them in a single framework when targeting the issue of tax havens. Tax policy could have a leading role to play as it is strongly focused on transparency and cooperation, always with the aim of simplifying and harmonising existing rules, to allow for fair and effective policies and above all to expand the democratic dimension of the state.

Although related policies from non-tax policy fields target tax haven jurisdictions aiming at different objectives, the tools and means of pressure, for instance financial help or the conclusion of trade agreements with the EU, are more or less the same. Hence the Commission should consider the possibility to agree on a common approach in view of joining forces, namely in the fields of anti-fraud, anti-money laundering, financial markets regulation and crime prevention.

Cooperation with third countries can be an important element for tackling fraud as regards customs, investigations, legal and administrative assistance and intelligence. Increasing the number and extending the scope (towards direct taxation) of anti-fraud agreements, such as with Switzerland, is necessary. It is, in this respect, lamentable that the draft anti-fraud agreement with Liechtenstein (which should cover direct taxation) is in limbo because of considerations relating to the need for unanimity in tax policy.

Concluding remarks

The full extent of money laundering in the EU cannot be quantified with precision, but all indicators suggest that it is widespread and on the rise. The problem is redoubled once considered in light of tax evasion, which has been increasing since the financial and economic crisis gripped the EU. The issue *per se* needs to be addressed effectively and systematically regardless of the overall conditions in the economic, financial and fiscal fronts, for the sake of mitigating a potent criminal threat, together with all the illicit or malevolent behaviours it engenders.

Nevertheless the eurocrisis has demonstrated that a state which is found in a precarious fiscal position and which must at the same time comply with the budgetary rules of the single currency, becomes ever more exposed to the pernicious effects of tax evasion, aggressive tax planning and money laundering.

Tax evasion and/or the unscrupulous misuse of legal loopholes in cross-border tax legislation further undermine the state's fiscal position, while it produces incentives for socially-detrimental profiteering in times of an economic downturn, it increases the chances for the corruption of officials and/or financial corporatists willing to circumvent or disobey existing rules and prevailing principles, therefore initiating a vicious cycle of mischief and illegitimacy.

The issues that have been presented in this Thematic Paper can and should be perceived as the criminal side, as the 'dark side' so to speak, of the eurocrisis. The invidious effects of tax-related crime are multi-faceted, ranging from criminality to corruption, to social injustice and asymmetric, distortive economic activity. To make matters worse, such crimes also have a more profound and corrosive effect on the institutional milieu of the polity, as they erode the trust and faith citizens have in democratic institutions and in the capacity of a directly elected government to improve the life of its citizens.

Finally, the European Parliament in its twin capacity as first the vehicle carrying the concerns and aspirations of European citizens and second, the co-legislator of the EU, must take the initiative in the struggle to preserve the values of justice and democracy in Europe and to ensure that economic activity is conducted for the sake of yielding benign results for all, not for enriching the privileged few. It is the legal and moral obligation of the European Parliament to have a pivotal role in preserving our lofty ideals and in pursuing these laudable ends.